

# Governor Ajith Nivard Cabraal: Strength & Stability



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The global economic environment has been challenging, with the US and Europe facing extreme difficulties. However, Sri Lanka through it all has remained resilient due to its macroeconomic fundamentals being strengthened through sound policy decisions. Sri Lanka does not blindly follow the world, the country looks within and ensures that it is strong internally, which has enabled it to face external shocks. Governor Ajith Nivard Cabraal is confident that the Sri Lankan economy is on the right track. He is watchful to ensure that no event externally or internally will tilt the sound balance. The Governor believes that Sri Lanka is strong enough if not better than other nations as the country moves forward as the emerging wonder of Asia.

By Udeshi Amarasinghe

Photography Menaka Aravinda and Mahesh Bandara

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**During the past few years the global economic and financial environment especially in the West has been turbulent, but Sri Lanka has remained resilient. How was this achieved?**

It is an interesting story. We need to understand that when a global turmoil takes place there is very little we can do to influence what is happening. In the past, our reaction was 'there is something terrible happening globally, so we have to suffer from it.' However this time we took a completely reversed stance; what we did was that we acknowledged that there would be many problems outside but prepared ourselves internally to be stronger to deal with it. As you know, a weak person is susceptible to any infection, but if you are strong you will not pick up the infection. So that is the premise on which we worked on. We strengthened all our macroeconomic fundamentals. We improved our debt situation. We were able to bring down our inflation and our interest rates. Unemployment was reduced significantly and we ensured that our financial system was stable. By doing what was necessary to strengthen ourselves, we were able to withstand external problems better. We took the shocks that came, and we did not transfer the shocks to the economy. That is what held us together during those very difficult times. Even now, the world is going through a bad period and even the President of the World Bank, Robert Zoellick has said that this is the most dangerous period in the world, economically. But the transmission of those shocks to our economy has been slow because we have been able to absorb most of it as a result of the strength we have built up.

**The Central Bank as the apex monetary and financial institution of the country has always taken stringent and at times unexpected decisions to ensure stability, would you say that the decisions made were correct?**

Of course. The proof of the pudding is in the eating. If we had erred, the whole country would have known. Stability is a very interesting phenomena. If you are stable, nobody notices. But, if you become unstable everybody feels it. If you have chaos, people can recognise it. But, if you have calm and peaceful surroundings, no one appreciates it. Therefore what we have achieved and what we have been able to deliver, through, perhaps unexpected, sometimes innovative, sometimes tough and maybe unusual strategies, is that we have been able to deliver economic stability to our country. In hindsight, people will have to acknowledge

that the decisions made were the right ones.

If You Have Calm And Peaceful Surroundings, No One Appreciates It. Therefore What We Have Achieved And What We Have Been Able To Deliver, Through, Perhaps Unexpected, Sometimes Innovative, Sometimes Tough And Maybe Unusual Strategies, Is That We Have Been Able To Deliver Economic Stability To Our Country.

**Bank shares around the world tumbled due to fears that the sovereign debt crisis in the Eurozone could spill into the banking system. What are your thoughts on this and how will this crisis affect Sri Lanka?**

Turmoil anywhere could be troublesome and a matter of concern. But, we have built our own system with the necessary stringent cushions. We cannot say that the turmoil won't strike us. It will. But at the same time if we are able to withstand the shock, then we will survive. That is what we have ventured to do. I believe that the turmoil in the world will be felt to some extent. But, the shock itself will not be transmitted too widely to our system. I am confident that we will be able to steer through this difficult period and come out, without a major upheaval.

**In your opinion what is the reason behind this recent crisis?**

It started off with various economic complications because policy makers had not carefully thought through. Greed and recklessness also played its part. At the same time, some of the global policy measures were very clearly not the right ones. But, what the world is going through now is a crisis of confidence, since economic stakeholders cannot see appropriate policy actions being taken on time. Economies work on confidence. That is the fundamental premise on which it is based. If that confidence is threatened, and the people are not able to feel comfortable with the system, then they naturally panic. Therefore what we are seeing today is definitely not the best thing, because markets are uncertain and there is turmoil. People are very worried and that has been essentially because many governments have taken too long to make their decisions. The leaders are not showing that they are in-charge and the fundamental truths we have been accustomed to and have taken for granted, have been threatened. Unless confidence is restored quickly and the people begin to feel that they can rely on the system that they have been hitherto relying on, there will be shocks to come

even in the future.

### **What about the Sri Lankan banking system? Are we safe?**

Yes we are. All the banks have been capitalised adequately. The banks have not been in anyway adventurous to speculative. We have seen the boards in the banking sector acting in a responsible manner. Payment systems are robust and thorough. The corporate governance structures are being adhered to. The overall macroeconomic fundamentals of the country, where interest rates are reasonable and unemployment is low, helps customers to repay their debts without undue tension. All these have made the entire system safe and we have been able to show that to the world. Also, we have not had any major tensions in the recent past, and our banks have not had to undergo the stress or tension that many other banks in some parts of the world have had to suffer.

**We In Sri Lanka Have Carefully Worked Through Our Macroeconomic Fundamentals. Sri Lanka's Debt To GDP Ratio In 2003 Was As High As 104%. Today, It Is Down To 81% Because We Have Been Careful About Borrowing. We Have Borrowed Only For Projects Where It Is Essential For The Growth Momentum To Be Maintained.**

**Then if we look at the US, they lost their sterling credit rating recently. What led to the US debt crisis and what lessons can Sri Lanka learn?**

The most important lesson is that you cannot live beyond your means, however big you may be. If you have to borrow and you are relying very heavily on borrowing you can get into trouble. So, that is a very important lesson. It is a very simple truth too. It is true with any economic unit, be it a family, an organisation or a country. It is not a lesson that we have to be rocket scientists to understand. It is a simple lesson that every person and country should keep in mind. We in Sri Lanka have carefully worked through our macroeconomic fundamentals. Sri Lanka's debt to GDP ratio in 2003 was as high as 104%. Today, it is down to 81% because we have been careful about borrowing. We have borrowed only for projects where it is essential for the growth momentum to be maintained. Earleir, we borrowed to eat bread too! We have also looked at the fiscal deficit. Governments have to be careful about how much they borrow to support their own budget each year. Sri Lanka has been able to bring the deficit down to 6.8% of GDP this year. In the US, it is nearly 10%. When you have a debt to GDP that is

very high, and you have a fiscal deficit at 10%, that effectively means that you have to borrow 10% of your expenditure for that year. When you do so, you do not give confidence. That hurts the sentiments and that is what has happened. Hopefully, the US will work out their problems and as the biggest economy in the world, their health is essential for the rest of the world to function well. We are hoping that would take place soon, and the world system will become a lot more stable as a consequence of stability returning to the US.

**The credit downgrade showed the need for a “balanced approach to deficit reduction that combines spending cuts with revenue-raising measures.”  
Would you agree?**

Of course. As I said earlier, you have to live within your means. I am not saying you have to just cut expenditure across the board. You have to spend money for various needs. But at the same time, you have to be selective and if you do not have the necessary finances to back it, you cannot incur massive expenses. There is a certain capacity within which you have to function, and if you go beyond that capacity and borrow too much, however strong you may appear to be, you are always risking your medium to long term health. The prescription is simple. But taking the medicine and getting better is not so simple. There are many political undertones to spending cuts. You need to reach a consensus amongst the different parties and that is always going to be a major challenge as we saw in the recent past in the run up to the August 2nd deadline that the US had to meet. Recent events showed that it is very tough, but it is not impossible. The US have to work through their own economic system to ensure that their house is put in order. Then they may get their rating back and regain their position, which has now been somewhat threatened.

**The Prescription Is Simple. But Taking The Medicine And Getting Better Is Not So Simple. There Are Many Political Undertones To Spending Cuts. You Need To Reach A Consensus Amongst The Different Parties And That Is Always Going To Be A Major Challenge.**

**Sri Lanka has invested in US Treasury Bonds. What is the status of this investment, considering the situation in the US. Is it a safe investment?**

The US Treasury Bond and Bill market is the most liquid market in the world and it is very easy to enter and exit the US treasuries. That is why many central banks

hold a reasonable quantum of their assets or their reserves in US treasuries. That has not changed appreciably, mainly because any change in that situation will take a long time to take place. We feel Sri Lanka's investment in US treasuries are safe and in order. At the same time, we have to look at yields carefully. In that regard, we have to look at other alternatives as well. There may be a shift in the world investment climate also in their search for fresh alternatives because investments have to be viewed from the point of safety and yield. There will emerge, reasonable alternatives in the short to medium term and even in the long term. When that happens the equilibrium may change in a gradual manner in time to come.

**Would you say that Sri Lanka is not as affected by the US and European crises because we are less integrated globally?**

In a way, that is true. There is greater chance of someone becoming more affected if the integration is greater. Here, we are seeing the lower degree of integration as being to our advantage as we are not as highly integrated as some of the other countries.

**What has been the strength we have built within the country?**

We have embarked on a path of stability and consolidation over the last few years. You cannot face a crisis suddenly. You have to do that gradually and that is the path that has been traversed by us. We have ensured that all our macro fundamentals are strengthened gradually. I will describe a few of them. Take growth; we have been a country that has been growing at less than 5% for a long time. Since Independence our average growth up until about 2003-2004, has been only around 3-4%. But, during the last few years we have been growing very strongly. Last year and this year, we are reaching an 8% growth.

Take unemployment; it was as high as 14% just about a decade ago. Today it is down to 4.5%. If you take inflation, it was around the 20% mark, but now it is down to the mid single digits. Our interest rates were also very high at one time, and people found it difficult to do business, but now it is down to manageable levels. In all these areas, we have given ourselves a cushion. Therefore, even if we have to increase or decrease the fundamentals if and when it becomes necessary for us to do so in the short term, we now have the space to do that. With regard to our overall strategy, we have to give credit to His Excellency, President Rajapaksa

for giving us the proper guidance. He has been a person who has always been conscious that we should have all our economic fundamentals at comfortable levels simultaneously. There are some countries where they are obsessed with one or two fundamentals. But in Sri Lanka, that is not the case. We try to ensure that our macro fundamentals are balanced. In the short term, you may sometimes see some as being weaker than others, but it doesn't matter, because we are on a path of consolidation. Furthermore, the Government has taken a big interest to ensure that the fiscal deficit is brought down. The fiscal deficit is consistently reducing and that has helped us to maintain inflation at low levels. Strategies of that nature have helped us immensely.

**With Regard To Our Overall Strategy, We Have To Give Credit To His Excellency, President Rajapaksa For Giving Us The Proper Guidance. He Has Been A Person Who Has Always Been Conscious That We Should Have All Our Economic Fundamentals At Comfortable Levels Simultaneously.**

**We saw inflation reaching 7.5% in July this year. Will we see it increase further?**

We expect inflation to moderate towards the end of this year. We will probably be able to record inflation for the year, at around 6%, which is a manageable number for an economy like ours. In that context, we would have done well, particularly because there is a fairly large portion of Sri Lanka's economy which is import driven. For example, 100% of our oil requirement is imported. That suggests that we will have to endure a reasonable amount of inflation that is imported from outside when our prices go up. Even with that, if we are able to record an overall inflation in the mid single digits, I feel we have done well. Of course, we need to continue that trend to ensure that we maintain our inflation at reasonable levels.

**Sri Lanka's \$50 billion gross domestic product will increase 8.5% this year, up from 8% in 2010. Though the global environment is somewhat unstable this has not deterred investors to Sri Lanka. The Colombo All Share Index surged almost 10%. What can you tell us about this?**

That is a reflection of the confidence that people have in the Sri Lankan economy. When you have an economy that is growing at 8.5%, people naturally sit up and take notice of it and they believe that there is something good happening. But at the same time, people don't only take into consideration what is current only,

since for investment decisions, trends are looked at as well. Investors want to see how our macro fundamentals are behaving in the longer term. They want to see how our economic platform is managed. They want to see whether the stability that we have both in the political and economic fields can be sustained. They want to see whether we have a good pool of resources, particularly people who can work, who can be trained and who will have the necessary knowledge. They want to see if our infrastructure is on a path of constant improvement. All these are important aspects of the decision making process for investment. Sri Lanka has so far been able to give the right signals that the enabling environment is being supported by the Government, and the private sector, and that we are improving our business practices. We have made good, solid advances in those areas. Based on all those aspects, I believe people have taken their decisions to invest and that will continue in time to come as well.

**All These Are Important Aspects Of The Decision Making Process For Investment. Sri Lanka Has So Far Been Able To Give The Right Signals That The Enabling Environment Is Being Supported By The Government, And The Private Sector, And That We Are Improving Our Business Practices.**

**The Sri Lankan rupee has strengthened almost 1% against the dollar this year. The Sri Lankan rupee is pegged to the US dollar. Would the Central Bank consider floating the exchange rate. Would that not be more beneficial for the country?**

Actually, our rupee is already floating. We have only allowed whatever trend to take place, on a gradual basis. That is because we want to ensure stability. We don't want to have too many fluctuations. It may seem as if we have a close peg with the US dollar, but realistically speaking, many currencies have close relationships to the US dollar. Whatever anyone may say, currencies have the tendency of moving in tandem with their main trading partners or moving in a rather consistent line with international currencies. As anyone can see, we do see a close relationship between the Sri Lankan rupee and the US dollar, but we must also understand that most of the transactions that Sri Lanka has with the outside world, are conducted in US dollars. That is why there is no real risk if the Sri Lankan rupee is closely linked to the US dollar, or if it is moving in sympathy with the dollar. I think the slight appreciation in recent times would have helped overall, because it also confirms that Sri Lanka has been on a path of improving



its productivity, and many companies have shown a clear ability to improve their productivity. At the same time, if the trend is for the Sri Lankan rupee to appreciate gently against the dollar, it must be allowed to happen, particularly because the US dollar itself has been depreciating quite heavily against some of the key currencies in the world. Let me also state that the rupee is not directly pegged, but is a floating currency. However, there will be a relationship that will be maintained with the US dollar.

**Sri Lanka sold a billion dollar bond in late July. About half the money was used to retire high cost domestic debt and the rest was deposited at the Central Bank to meet future debt payments. What can you tell us about this?**

Well, you can say it is a very good strategy and it is based on sound common sense. If you can borrow at a lower price and then settle a debt which is at a higher price, that would be something that anyone would want to do. So, that is good. The second part of the loan proceeds has been kept in order to retire future debt as and when it falls due. Again, that shows good debt management, which is well focused and confirms that we have a very high competence level in debt management. That is the right way to go and I believe the Government has done well to do what it did.

**Sri Lanka has built up its gold reserves to a great extent. What was the thinking behind this and what can you tell us about the current gold prices?**

Gold prices have gone up through the roof mainly because of the acute uncertainty that the world is facing. Way back in 2009, we believed that the growing uncertainty that was developing in the world would lead to investors seeking refuge in gold, and that is one of the reasons why Sri Lanka opted to have a reasonable chunk of its reserves in gold. That decision has paid off quite well, since gold prices have reached very high levels now. That increase has also vindicated our decision to move to gold which resulted in us realising an exceptional profit on the sale of a portion of it.

Gold will remain as an alternative to global currencies, because it has no government to issue it and since there is a physical limitation on the availability of gold. We also have to understand that gold has an intrinsic value in itself, and in

times of turmoil people like to hold assets, which have intrinsic value. That is the thinking that prompted us to move to gold, and that is the thinking that has made other people to follow gold and as a result, gold prices have surged as much as it has done. We should also know that there will be a tendency for gold to come down in price when global stability returns. We have to understand that there is always that point to be conscious of, and while you may sometimes make very high capital gains, sometimes it may not be as spectacular. But overall, on a long term basis, gold can be a good storehouse of value and you need to keep that as a part of your portfolio.

**The Central Bank recently relaxed forex controls allowing citizens and foreign residents to engage in a series of forex transactions without seeking permission from the state, improving economic freedoms. Can you tell us the thinking behind this and what measures have been taken?**

When you look at our programme of gently relaxing some of the controls, you would notice that it has been worked out as and when we improve our reserve capacities and capabilities. As and when you become stronger externally, you have a greater ability to relax some of the restrictions that you had. Many of the restrictions that were put in place in the past were to ensure that you will control very closely, any outflow of foreign exchange. But if you do have enough foreign exchange and you have sufficient confidence that foreign exchange will not move out in an uncomfortable way because people have greater confidence in your economy, then there is no need to hold to it with locks, vaults and doors. You can open it out to the world.

**But If You Do Have Enough Foreign Exchange And You Have Sufficient Confidence That Foreign Exchange Will Not Move Out In An Uncomfortable Way Because People Have Greater Confidence In Your Economy, Then There Is No Need To Hold To It With Locks, Vaults And Doors. You Can Open It Out To The World.**

In the same way, if you keep the doors open, money will come in faster, and not necessarily flow out. The earlier thinking was that if you open the doors, you will have money going out. Our thinking is if you have a good atmosphere created within your economy, and you open the doors, money will come in. This is what we have done. Earlier people found it inconvenient because of some of the practices that we had. Now, we have relaxed those practices so that people can

go about their business in a much easier manner. Our series of relaxations in a controlled manner, has given the business confidence to all investors and stakeholders. That policy of gradual relaxation will take place even in the future.

We must also know that if you lift a control that does not mean that regulation has stopped. Sometimes, you will have some control exerted by some other economic player. Say for example, if you want to send money for your child's education, the practice in the 1990's was that people had to come to the Central Bank and get it approved by the Exchange Controller himself. But, thereafter that authority was delegated to a commercial bank to which institution a person had to show the necessary documentation to get the money released. The bank was acting as the agent of the Controller of Exchange. In the same way, now we have relaxed procedures to include overseas investments and several other transactions. But, different persons or institutions have been granted the authority to make the approval on behalf of the Central Bank and the Controller of Exchange. In that sense it is much easier and more convenient, as it allows people to do business much faster and better. When you have extensive resources to back such decentralisation, then you are that much stronger and you don't have a risk of sudden out flow.

**The latest forex relaxation is coming as some pressure is developing on the rupee, due to rapid credit growth which is excess reserves in the banking system. Would you agree?**

I will not say it is an acute problem for us, but credit growth is a little higher than what we expected. Sometimes you do get surprises by seeing something growing faster or slower than you expected. In the past, credit growth has been quite slow and we have been rather concerned about it being too slow. But now, we have the reverse happening, where it is a little faster than we expected. We have studied the background to this situation and we believe that we will see a moderation in the next few months, which will ensure that we will have a more manageable credit growth situation by the end of the year. That is why we are not unduly worried about it.

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**In the recent past we have seen bank interest rates decreasing. Do you think it will decrease further?**

Interest rates are a function of inflation, money supply and money availability. At the present time, we believe interest rates are behaving in the right way. In time to come, there could be some tendency for the banks to tighten their own intermediation costs. We still think that the overall intermediation margin that banks have between their lending and their borrowing is a little too high, we have in fact had several discussions with them to find ways and means in which this could be reduced further.

Of course the intermediation margin has reduced quite significantly over the last few years, particularly during the last one year, but there is even more space for it to tighten further. These movements are gradual processes. It is not something that happens overnight and we are confident that in time to come with volumes increasing there will be opportunities for the banks to tighten their margins so that the overall intermediation cost could reduce even further.

**Where does Sri Lanka stand in relation to its balance of payments?**

We will have a surplus this year. It will be sufficiently high, which will be encouraging. Even in the last few years, other than 2009 which was an extraordinarily difficult year and we had a balance of payments deficit, we have recorded comfortable surpluses.

**Is the economy moving in the expected direction?**

Yes, very much so. Most of the macro fundamentals that we had planned to achieve have been realised. Of course, it is a gradual process and we have to ensure that this movement does take place on an overall basis. But the movement is pretty much in line with what we had predicted. In fact, at the beginning of the year we set out our targets in our road map, and what we have achieved so far shows that we have been almost spot on.

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**The relationship between Sri Lanka and the IMF have improved**

**significantly with the seventh installment also being paid and the IMF making the decision to review every six months as opposed to every three months. What can you tell us about this?**

We have come a long way particularly when you know that in the past, Sri Lanka has never been able to go to the second tranche on any IMF programme. We have had several programmes in the past and our credibility was low with the IMF as a result of the fact that we in the past have never been able to go beyond the first down payment. That means in the first review itself, we had failed in the past. The present situation clearly shows that we have had a complete turn around this time and we have been able to deliver on all what we have undertaken. What is also most important is that we have structured a programme with the IMF which is a workable programme and we have been equal partners in the process.

One of the problems we had in the past was that the IMF had been the dominant partner in preparing the programme and the country was not able to deliver on what was imposed on it. This time round we have been able to negotiate it well to ensure that we will have a workable agreement and that workable agreement has been delivered. Therefore, the confidence levels of the IMF on Sri Lanka has improved dramatically. They now believe that we have what it takes to deliver on a sound economic agenda. We have done well on that and we will continue to do well on that. I am sure that in time to come, the credibility of Sri Lanka with the IMF would have improved to such an extent that we will have a very good relationship even for the future.

**What Is Also Most Important Is That We Have Structured A Programme With The IMF Which Is A Workable Programme And We Have Been Equal Partners In The Process.**

**In the 2011 Budget special provisions were given for SMEs, where banks were to have a separate fund and support was to be given to this sector to revive them. But we are yet to see any support. Why is this?**

That is happening. The fund has been created and banks are already lending money from that fund. The operating guidelines have been issued to the banks as to what areas these funds can be utilised. It is functioning satisfactorily. Of course now it depends on the requests for loans from banks and also for the banks to find viable projects to lend to. That matter is well under control and the banks and the

borrowers will work out the necessary modalities. As you know, the fund was created so that banks would lend for the long term. For example, for replanting, new planting and SMEs which will require a longer period of time to produce results. In that sense the fund has been fully devolved on the banks to use and give credit. It is now up to the SMEs and those who wish to take those loans to seek those loans under the particular sectors.

**The CRIB was put in place as a safety mechanism. However we see that banks use this to deny loans. At times the information with the CRIB is wrong or not updated and as such those who have no credit issues are still penalised. What are your thoughts on this?**

That is a situation of the past because the CRIB is now online and banks do not penalise people unfairly. It is only those who do not pay on time, or those who do not repay their loans who get penalised themselves. The CRIB is the central authority that provides information about the payment details of individuals and corporates. If the person has been paying well that fact will be conveyed to the bank. If he has been defaulting, that fact also will be conveyed to the bank. The banks are the recipients of the credit information. Therefore if a person's record is bad, such person cannot really blame the depository of information. The information that the CRIB provides is strictly based on the performance of the debtor.

What is important for us is to understand that a bank also needs to have confidence about lending to a person. If the person seeking a loan has been a habitual defaulter, the bank will be very foolish to give money to that person because they will be risking the money of the depositors from whom the bank has received the money. Therefore when the bank is giving money, they want to be sure that the persons who are borrowing are people of good standing and calibre. That decision is to some extent based on the information that the bank receives from the CRIB. Although of course it is not entirely on that alone, the bank will look at the character of the person and project prospects as well.

**The EPF has been in the limelight with the fund being utilised to invest in private entities. Is that right? what are your thoughts on this?**

The EPF has been investing on behalf of the millions of its members, the Sri Lankan public. Why should the Sri Lankan public be denied the opportunity of

investing their monies in the best stocks possible? Also, are we to only give that opportunity to the foreign funds or the elite? At the time the stock market started moving up, the EPF had quickly invested funds in very good stocks and they have done extremely well. The wisdom of those decisions will be clear in a few years time when the market has grown to a very high level. Then, people will realise how important it was to invest in good quality stocks at the time we did. The EPF will also then be able to provide a very good income to its members. The extraordinary gains that the EPF has made overall in its investment decisions will be the best answer to that question.

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**What about appointment of directors, the EPF nominees, what can you tell us about that?**

EPF will only support directors that they wish to support, the same way that any private individual who buys shares will want to support directors whom they believe are competent. The EPF cannot be denied that right just because it is the EPF. The EPF should not say we have nothing to do with the election of directors, because if the directors do something wrong and the shares go down in price, who will the people and investors go and ask? People will then ask the EPF as to why the EPF didn't do anything about it. In my view, the EPF has a responsibility to be conscious as to who they support to become directors in companies they have invested. That is a very important right and responsibility, which the EPF should not shirk. The EPF should, therefore take part in elections of directors as a responsible shareholder.

No one must take the EPF for granted in the same way that they do not and cannot take any of the other big investors and shareholders for granted. All over the world, corporates are conscious as to who their investors are, who their shareholders are. Directors have to be responsible to the shareholders. The shareholders' rights, and the shareholders' own assessments are very important. Therefore when the EPF invests, EPF will act in a similar way to other professional funds from abroad. Therefore I think if the EPF does take part in the

election of directors it is a positive outcome, and they must exercise their right so there will be better governance and corporate responsibility shown by directors.

**Another aspect is the private sector pension scheme, which was proposed in the 2011 Budget. What was the thinking behind this? The proposed private sector pension scheme is a form of social security but also contributes to raise the level of national savings. What are your thoughts on this?**

It is very important that we have enough pension schemes, especially in an era where interest rates are going to be low. In the future interest rates are going to be lower than what we have been used to, and people will need to have support for their future. That is why the private pension schemes were proposed. That is why some banks, insurance companies and finance companies already have various pension funds to which people subscribe.

But a universal pension is also important and there has been a request for this from many quarters. Sri Lanka is the only country where people have protested saying that they do not want a pension! In France they are taking to the streets saying that they want a pension. People must understand that they have to earn the pension. A pension does not come as a right from society. A pension does not come through taxes. Pensions have to be earned. You have to pay for your pension. You have to work for it. That is the way it is done everywhere in the world. You have to contribute towards your pension. If I am not interested in contributing to my pension, then who will? Can I expect you to work and earn and pay my pension?

After we have understood that, we have to contribute towards our own pension and earn our pension. Understanding the rest is easy. Also, when you have the ability to work and earn, you have to save for your future, so that various schemes and institutions will be able to provide you with an income when you cannot work anymore. That is a very simple truth. When that is understood very clearly by people, I think it will once again be time to restore and develop a pension fund. I am hoping that such a scheme will see the light of day soon, because I myself am very keen to see pension schemes developed by the private sector or the Government or anyone, because it is needed. In the past, you could make a deposit at a finance company, receive about 25% interest and then live comfortably. You did not need to have a big pool of finances to sustain yourself.



But when the interest rate is only 7-8%, you cannot do that. In other countries, the interest is as low as 2% today! In that scenario, you have to supplement your income for the future by having pension schemes. The sooner people realise this and the sooner that people realise that a person has to support his own pension, I think we will be on the right track.

**Rapid economic development is happening in the country. Through the 2011 Budget many incentives and concessions were given to the private sector. Corporate tax was reduced significantly. But what we see is that the corporates make huge profits but they are not contributing to the economy. It is the middle income and low income earners that are taxed. What are your thoughts on this?**

We have to understand the philosophy behind the reduction of taxes. It was not only to give the tax payers benefit. It was also to ask them to plough back some of their profits into businesses and develop their own businesses.

When you make more and more profits, and are paying less and less taxes, such savings are retained with you, and you can put it back into additional investments and that will create more economic activity. That was the philosophy behind this whole exercise. If you look at the overall spectrum of business we have to admit that there has been a significant amount of reinvestment. Our investment ratio has also gone up quite significantly and I am confident that that situation will be maintained and improved in time to come.

**We Have To Understand The Philosophy Behind The Reduction Of Taxes. It Was Not Only To Give The Tax Payers Benefit. It Was Also To Ask Them To Plough Back Some Of Their Profits Into Businesses And Develop Their Own Businesses.**

**Currently we see that there are Corporates which have formed cliques and are supported by the Government or we see them more with the Government. What can we do to rectify that and give everyone an opportunity?**

Governments must help people to do business. A problem will arise only if the Government is unduly helping some people and not others. Everyday, I get visits from various foreign ambassadors who are canvassing for business or advantages for companies of their own country. Why are they doing that? They are supporting

their own corporates and businesses. We should have that feeling as well. What has happened in Sri Lanka is that sometimes we think the Government should not help our local businesses. That is entirely the wrong premise. The Government must help them.

If somebody wants help they must come and ask the Government and the Government is obliged to help them. If, for example, some local corporate is going to Bangladesh or Singapore, and wants to set up a business there, our Government must help them. Recently, there was a company that wanted to carry out construction contracts and power generation projects in Bangladesh and Uganda and we helped them. We must understand that it is only if we help them, they will be able to make their businesses grow.

How do you think that Samsung of Korea or McDonalds of US or Mitsubishi of Japan or TATA of India grew to these international levels? They grew because their governments assisted them. Their respective governments helped them initially to setup businesses and find markets. In the same way, our Government must also help in different ways.

**Governments Must Help People To Do Business. A Problem Will Arise Only If The Government Is Unduly Helping Some People And Not Others.**

At the same time, businesses must also exercise due diligence and care when moving forward. They must not expect everything from the Government either. They must also try to do some of the work themselves. Then they can grow faster. This is not an isolated sterile relationship. It is a dynamic relationship, where people have to get together and help each other. For the Government if a company becomes successful they will probably pay a greater amount of taxes, which is good for the country. That is the way to look at it and we have to understand it from that perspective too.

**The rich are getting richer and the gap between the rich and poor is widening, what can be done to rectify this?**

That is always a situation that can develop. In Sri Lanka the tendency for that to happen would have been much greater if not for the fact that we have made every attempt to ensure regional development and equitable distribution. In Sri Lanka's growth and business model, attention has been given to regional development and that is working well.

That is why there are five new ports being built simultaneously in different parts of the country; that is why there is a new airport being built in the South; that is why roads and highways have been constructed all over so that people can move about freely to other parts of the country and make investments.

The situation where the rich become richer is true, not only in Sri Lanka but all over the world, because there is a tendency when you have a bigger pool of resources for it to be multiplied into something greater, faster. If you have 1,000 rupees and you invest it in a deposit you get 100 rupees, but if you have one million rupees and you invest it, you get a much larger amount. Obviously the rich person has a greater capacity, and therefore you might find that they will earn increasingly higher incomes. That is not something that we can stop or should stop. But at the same time, it is important to ensure that the least of our poor persons are upgraded to a higher level consciously and continuously. That is vital because over a period of time they will then become stronger and stronger.

What we have to do is to ensure that we reduce our poverty levels right across the nation, and at the same time ensure that more people have opportunities, so that those who are poor will be able to make use of opportunities. If we do that we will be on the right track. That is what we are attempting to do and in many instances it has worked very well, although in some instances it may not have been that perfect. All in all, I think that we can say that Sri Lanka has done better than most other countries.

**What We Have To Do Is To Ensure That We Reduce Our Poverty Levels Right Across The Nation, And At The Same Time Ensure That More People Have Opportunities, So That Those Who Are Poor Will Be Able To Make Use Of Opportunities.**

**What can you tell us about the oil hedging deal? What was the thinking behind this?**

I said it then and I say it now, hedging is an important risk management tool for us to use. Hedging means risk management; when you are doing risk management you are reducing the impact of risk of unforeseen or unfortunate incidents attacking you and then crippling your business. It is a very important factor in business to be able to hedge or carry out risk management. That simple truth will remain under any circumstances.

In that context, if you look at one of the judgments that was delivered about the CPC hedging transactions, it was stated that one of the banks had sold instruments which were not risk management instruments, but were speculative instruments. That is completely different to what was authorised by the Cabinet of Ministers and the Finance Ministry when the CPC was allowed to enter into hedging transactions.

In that case the learned arbitrators clearly held that the transactions were not risk management transactions but were speculative instruments. That is why the decision of the arbitration panel was in favour of the CPC.

So, the lesson is that proper hedging was the right thing to do, but unfortunately it happened in the wrong way. Based on that unfortunate experience, we must not think that hedging is bad by itself. It will also be good to remember that hedging is being resorted to by many thousands of companies all over the world and will continue to be so in the future as well.

**We can see from one side there was a positive response where the international arbitrator voided the Sri Lanka oil hedge deal in favour of the CPC and against the Citi Bank and on the other the London courts gave a verdict in favour of Standard Chartered Bank (SCB). What are your thoughts on this?**

That shows that the legal systems have different ways in which the same matters can be perceived. I also noted that the arbitration award and what the Central Bank determined are similar. You may remember the position that the Central Bank took after our own investigation into these transactions where we had made known through a public statement that in our view the transactions were tainted and that they should not be given effect to. That same position has been upheld by the international arbitration panel where all three members were highly proficient in derivative instruments. The panel has said that the transactions that were entered into by CPC were not instruments that were used for risk management but, were entirely speculative. Therefore what this means is that these were not derivative transactions. It is on that basis, that those transactions had been voided by the arbitrators. Now, that view is entirely consistent with the view that was taken by the Bank Supervision Department and the Monetary Board. That is why I tend to agree more with the arbitration award. I presume that the CPC will naturally appeal on the verdict that went against them and

probably explore their submissions on legal lines.

**If we move on to another area, Sri Lanka hopes to win the bid to host the 2018 Commonwealth Games. What mechanisms are in progress for Sri Lanka to win the bid?**

Obviously, when you contest you think you can win and you want to win. Right now, we strongly believe we have a very good chance of winning the votes that will give the opportunity for Hambantota to host the 2018 Games. The Commonwealth Games Federation is made up of 71 countries, each one of them having a vote. If you look at the structure of the previous games, 17 out of the 20 games have been hosted by just five countries. Only three games have been hosted by the other countries. This means that 63 countries have never hosted the games and Sri Lanka is one of them. Today, we are coming forward and saying that we want to host the Games. We have a very good model and plan, and we have shown a capacity to be able to deliver on that. We are therefore confident that the voters will look at that and vote for us.

**Obviously, When You Contest You Want To Win. Right Now, We Strongly Believe We Have A Very Good Chance Of Winning The Votes That Will Give The Opportunity For Hambantota To Host The 2018 Games ... We Want To Get Ready, We Want To Deliver A Great Games.**

When Malaysia hosted the Games in 1998, for which they bid in 1991 their macro economic fundamentals were almost identical to what Sri Lanka has today. That confirms that Malaysia had the capacity then, and if so Sri Lanka will have the capacity now. Of course, we concede that Australia will be a good host as well. They have already hosted the games four times, and they have the experience since they are bidding for the fifth time! Nobody will deny that they have the capacity, the ability, the money, and all that. They themselves boast that they are already event-ready. But we are saying that we want to get ready and we want to deliver a great Games. If the Games Federation and the Commonwealth Games Associations support us, we will certainly do an outstanding Games.

**Is it not too early for Sri Lanka to bid for the 2018 Commonwealth Games?**

No, not at all. That is why I gave the example of Malaysia. In 1991 when Malaysia bid for the 1998 Games, they had almost identical macro fundamentals; their GDP

was 50 billion dollars, like ours; their per capita income was 2,700 US dollars, almost like ours; their growth was 9%, very similar to ours of 8.5%. They were in that situation when they bid for the Games. There is always an optimum time that you need to host such a Games and you want to do it at that time. Sri Lanka has a fantastic opportunity of rebranding and wants to do it now. We want to show the world now that we have put behind us the terrorism and the tsunami that we had to suffer from. We want to show the world that our reconciliation process is now emerging and all communities are getting together and working. It is a good opportunity for us to brand Sri Lanka so that the rest of the world will recognise us for that. We are confident that the voting nations will think that it is the right time for Sri Lanka to make this bid.

### **Can the Sri Lankan economy afford it?**

Of course we can. We have already earmarked what is needed for it. We will also create a legacy where the private sector will get fully involved, particularly in developing the Commonwealth Games village, which will double up as a university in the future and the media centre which will become a BPO centre in legacy. Many hotels will also be built by the private sector. In a similar manner there are many synergies that have already been planned and we think that the huge benefit and the investment that will take place as a result of the Hambantota Games being promoted and worked out, will generate fantastic opportunities that will be created within the economy.

The Hambantota sports city will also be a massive magnet for other developments. Sports wise, Sri Lanka will be able to have an appetite for many competitions in the future. If we take Malaysia as a parallel once again, before the games were hosted in Malaysia, Malaysia could only win about four medals per Games. But after the Games were hosted in Malaysia, they were winning as many as 35 medals at each of the subsequent Games. That shows that their young people had developed an appetite for winning. We are also putting together a seven year sports development plan, so that Sri Lanka's young athletes, will be able to train methodically for the Games.

The branding of the country is another very vital part of the whole exercise. When a country hosts a games such as the Commonwealth, a certain aura is generated around that country. That is why some countries proudly say they have hosted the Olympics, or they have hosted the World Cup, or they have hosted the Football

World Cup! Why do they say that? They say that because that gives them a certain advantage. When a country can say they hosted games such as the Commonwealth Games, the country is showing the world that they have the ability, the strength, the financial capability, the people and the professionalism to do a mega project of this nature. Now, that is very important for our people to understand. It is not just about having athletes performing. That is the outward show. But, behind that show, we have to do so many other things to ensure that it is managed well and that is a huge professional exercise. It also has our 'can-do' spirit conveyed to the rest of the world and that is another most vital aspect of our bid. Prime Minister Mahathir Mohammed said, he was very keen to showcase Malaysia to the rest of the world when they made the bid. In his book he states, "I wanted to showcase Malaysia to the world. I was fed up with people thinking that we lived on trees." Those were his words. He is saying what he said because there is a sense of frustration because Western societies sometimes do not take emerging nations seriously enough. They think we can't do it. But we must show we can. Australia is a country with only 20 million people. If they can do it, why can't we? If we can beat Australia in cricket, doesn't that mean our team is good enough? We have to understand that there is a massive need for us to get our mindsets right, and if we do that, we will have an extraordinary future for the whole of Sri Lanka.

### **What can Sri Lanka expect in 2012?**

**His Excellency, President Rajapaksa Has To Be Given Enormous Credit For Guiding Us Through A Very Difficult Period And For Us To Now Have This Inspiration And Hope. We Have To Translate That Inspiration And Hope Into Reality And Prosperity, So That We Can Really Do Something Extraordinary For The Country And Put Sri Lanka On A Prosperous Footing.**

2012 will be the third full year of peace, which we have won after much pain, struggle and courage. We are now on a new growth path. It will be a good year for us and we need to work hard. I am confident that the economic aspects of our country are now settling in and people are beginning to have greater confidence and greater ability to understand that. It is going to be something permanent and the third year will definitely be a good year and I am looking forward to that.

It is also clear that Sri Lanka is now on the threshold of a huge take-off. We have

the ability to take-off and to do something extraordinary. The vision that Sri Lanka will be the wonder of Asia is not an empty suggestion or a hollow slogan. It has deep meaning.

We have achieved much during the last few years. His Excellency, President Rajapaksa has to be given enormous credit for guiding us through a very difficult period and for us to now have this inspiration and hope. We have to translate that inspiration and hope into reality and prosperity, so that we can really do something extraordinary for the country and put Sri Lanka on a prosperous footing. The next year and the future will provide that opportunity for us and what we make out of it will be what we can deliver to our future generations.





